STATE OF CALIFORNIA PETE WILSON, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

April 17, 1995

DOCKET FILE COPY ORIGINAL

RECEIVED
APR 18 1995
FCC MAIL ROOM

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20036

Re: PR Docket No. 94-105

Dear Mr. Caton:

Please find enclosed ten copies of an order issued by the California Public Utilities Commission ("CPUC") at its conference of April 5, 1995 which is relevant to the above-referenced proceeding. In this order, the CPUC authorizes cellular carriers to bundle equipment and service.

Please include this official publicly-available document of the CPUC as part of the public record in this proceeding.

Sincerely,

Ellen S. LeVine
Counsel for CPUC

ESL:cip

Enclosure

cc: All parties of record (w/o attachment)

No. of Copies rec'd 029
List A B C D E

Mailed
APR 7 1995

ALJ/MFG/tcg

Decision 95-04-028 April 5, 1995

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the regulation of cellular radiotelephone utilities.	))))	I.88-11-040 (Petition for Modification filed July 12, 1993)

(See Appendix A for List of Appearances.)

I N D E X

ORDER MODIFYING DECISION (D.) 90-06-025 AND D.90-10-047

I. Summary

In this decision, we substantially relax our prohibition against the practice of "bundling," the combined sale of discounted cellular telephone equipment and tariffed cellular service. We are persuaded that applicable statutes permit us to take this action. We are further convinced that, subject to some carefully constructed conditions, bundling will result in consumer benefits in the form of reduced prices for cellular equipment. We take this step somewhat reluctantly, with a realistic recognition that the current duopoly of cellular service wholesalers prevents the more direct price competition in the cellular service market that we would prefer to see. In these circumstances, the equipment discounts that bundling makes possible provide an indirect substitute for price competition for cellular service.

II. Background

A. Bakersfield's Petition

Bakersfield Cellular Telephone Company (Bakersfield) filed a petition for modification of Decision (D.) 89-07-019 (32 CPUC 2d 271) and Ordering Paragraph 16 of D.90-06-025, 36 CPUC2d 464 at 517, on July 12, 1993. The relief requested in Bakersfield's petition would have the effect of removing the current prohibition on "bundling," the practice of packaging cellular telephone equipment with cellular service and discounting the price of the package. More specifically, Bakersfield seeks permission for cellular agents to voluntarily condition equipment price discounts on the cellular end-user's agreement to activate service with a designated cellular service provider and for

cellular utilities to bundle their own cellular service with discounted cellular equipment. Cellular services and equipment would continue to be offered on a stand-alone basis.

Protests to Bakersfield's petition were filed by Airtouch Cellular (Airtouch), Cellular Carriers Association of California (CCAC), Division of Ratepayers Advocates (DRA), GTE Mobilnet of California Limited Partnership, McCaw Cellular Communications, Inc. (McCaw), and Nextel Communications, Inc. (Nextel). These filings addressed, among other matters, whether statutory and common law authorities permit bundling.

In response to Bakersfield's petition and the various protests to the petition, the Commission held a prehearing conference (PHC) on March 25, 1994. Parties participating in the PHC agreed to address the impact of bundling on wireless telecommunication providers, tariff disclosures, customer premise equipment (CPE) providers, consumers, and to examine the experience of states that allow bundling. Further to the extent that legal issues were not already addressed in the protests to Bakersfield's petition, parties were afforded the opportunity to brief any such legal issues.

Subsequently, by Administrative Law Judge (ALJ) Galvin ruling of April 14, 1994, a sixth issue was added to the evidentiary hearing phase. This additional issue resulted from a March 4, 1994 ALJ ruling which granted Utility Consumers' Action Network's (UCAN) motion to consider the leasing or renting of cellular equipment by cellular carriers or their agents as an alternative to the bundling of cellular equipment with cellular services.

An evidentiary hearing on the identified bundling issues was held May 16 through May 20 and on May 23, 1994. Testimony was received from Airtouch, Bakersfield, Cellular Agents Trade Association (CATA), CCAC, Cellular Resellers Association, Inc.

(CRA), DRA, McCaw, UCAN, and U.S. West Cellular of California, Inc./U.S. West NewVector Group, Inc. (U.S. West).

Opening and reply briefs were filed on June 17 and June 24, 1994, respectively. Although the matter was submitted on June 24, 1994, it was reopened in response to CATA's motion of July 20, 1994 for leave to late-file its opening brief. No protest to CATA's late-filed motion was received. CATA's motion was granted by an August 22, 1994 ALJ ruling, and CATA's opening brief was received on the same day the motion was granted. The proceeding was resubmitted on August 22, 1994.

B. History of the Bundling Prohibition

The current restrictions on the bundling of cellular equipment and services derive from three decisions arising in two different procedural contexts.

1. CRA v. PacTel Cellular

D.89-07-019, 32 CPUC2d 271, which resulted from a complaint by CRA against PacTel Cellular (predecessor to Airtouch), Los Angeles SMSA Limited Partnership (LASMSA), and two cellular equipment dealers, established a prohibition against discounting a package of tariffed and unregulated products by utility agents. Specifically, the complaint dealt with noncertificated third parties, the equipment dealers, providing free installation of cellular telephones and antennas for customers who concurrently purchased cellular equipment from the dealers and retail cellular services from certificated carriers. Based on the facts presented in that case, we concluded that Public Utilities (PU) Code §§ 532 and 702 made it unlawful for utilities or their agents to offer discounts on cellular equipment that were contingent upon the purchase of cellular service. Hence, we prohibited the practice of bundling cellular equipment with cellular service and discounting the package.

D.89-07-019 left open the issue of whether Airtouch or LASMSA had actually violated PU Code §§ 532 and 702. The case was dismissed on December 6, 1989 without addressing the alleged violations.

2. **The Cellular Investigation**

In our investigation into the regulation of cellular utilities, I.88-11-040, we addressed the blanket prohibition of equipment discounts tied to the purchase of cellular service. In D.90-06-025, 36 CPUC2d 464, we permitted cellular carriers, upon approval of an advice letter request filed in accordance with the provisions of General Order (GO) 96-A, to provide, cause to be provided, or permit agents or dealers or other persons subject to the cellular carrier's control to bundle service with equipment price concessions, articles, or services of other than nominal value[1] paid for or financed in whole or in part by the service provider.

By implication, the order appeared to allow cellular carrier's agents, dealers, or other persons subject to the cellular carrier's control to bundle service with equipment price concessions or articles that are not paid for or financed in whole or in part by the service provider.

D.90-06-025 was subsequently modified by D.90-10-047 to remove the possibility of obtaining authority to bundle through the advice letter procedure. Thus, it became unlawful for cellular carriers to bundle significantly discounted cellular equipment with cellular service and for agents, dealers, or other persons subject to the cellular providers' control to bundle cellular service with equipment price concessions of more than nominal value paid for or

1 By D.92-02-076, 43 CPUC 2d 367, 373, 377 (Ordering Paragraph 6) and D.94-04-043, we defined nominal value to be not more than a retail value of $25.

financed in whole or in part by cellular providers. Again, by implication, the order continued to allow cellular providers, agents, dealers, or other persons subject to cellular providers' control to bundle cellular service with equipment price concessions of less than nominal value.

III. Legal Issues

Our previous decisions on bundling are grounded in the provisions of relevant statutes. In response to Bakersfield's request that we permit some forms of bundling, parties provided legal arguments on the statutory basis for the bundling prohibition in their comments to the petition and in their opening and closing briefs. These arguments center on PU Code § 532, PU Code § 702, Business and Professions (B&P) Code § 16727, and B&P Code § 17026.1.

If bundling is legally prohibited, there is no need to consider Bakersfield's petition further. Therefore, we will first address the legality of bundling before weighing the advantages and disadvantages of bundling as presented in evidentiary hearings. We will examine these statutes to see whether the bundling of cellular service with discounts on cellular equipment is prohibited and to determine the extent, if any, of our discretion to authorize the relief Bakersfield requests.

A. PU Code § 532

Parties supporting the position that PU Code § 532 makes the bundling of cellular equipment with cellular services illegal include CRA, DRA, and Nextel.

PU Code § 532 states:

> "Except as in this article otherwise provided, no public utility shall charge, or receive a different compensation for any product or commodity furnished or to be furnished, or for any service rendered or to be rendered, than the rates, tolls, rentals, and charges

> applicable thereto as specified in its schedules on file and in effect at the time, nor shall any public utility engaged in furnishing or rendering more than one product, commodity, or service, charge, demand, collect or receive a different compensation for the collective, combined, or contemporaneous furnishing or rendition of two or more of such products, commodities, or services, than the aggregate of the rates, tolls, rentals, or charges specified in its schedules on file and in effect at the time, applicable to each such product, commodity, or service when separately furnished or rendered, nor shall any such public utility refund or remit, directly or indirectly, in any manner or by any device, any portion of the rates, tolls, rentals, and charges so specified, nor extend to any corporation or person any form of contract or agreement or any rule or regulation or any facility or privilege except such as are regularly and uniformly extended to all corporations and persons. The Commission may by rule or order establish such exceptions from the operation of this prohibition as it may consider just and reasonable as to each public utility."

CRA reads the section's prohibition against any public utility refunding or remitting, "directly or indirectly, in any manner or by any device, any portion of the rates, tolls, rentals, and charges" specified in its tariffs as a direct proscription of bundling. It further argues that the statute's ban on indirect refunds or remittances includes the payment of commissions and the offering and paying of rate rebates in the form of equipment rebates.

DRA bases its arguments on D.89-07-019's conclusion that a special rate offered on one product, conditioned on the purchase of a tariffed product, constitutes an indirect and unlawful discount on the tariffed product. DRA further argues that bundling is illegal pursuant to PU Code § 532 irrespective of whether or not it is done voluntarily by cellular providers or agents.

Nextel cites the three Commission orders we discussed earlier (D.89-07-019, D.90-06-025, and D.90-10-047) to support its view that we have found bundling to be illegal. As we have discussed, D.90-06-025 permitted utilities to seek the Commission's authorization through the advice letter procedure to bundle equipment price concessions of other than nominal value financed or paid for in whole or in part by the service provider. However, D.90-10-047 modified D.90-06-025 by removing the possibility of obtaining authorization through the advice letter procedure and to restore a ban on the practice of bundling cellular service with significant equipment price concessions paid for or financed in whole or in part by the service provider.

Parties which argued that PU Code § 532 permits the bundling of cellular equipment with cellular services include CCAC and Airtouch. CCAC, cognizant that we concluded from the facts considered in D.89-07-019 that the use of equipment price incentives to attract new cellular service customers is contrary to PU Code § 532, reiterates our recognition in D.89-07-019 that cellular customers could benefit at least in the short term from the discounts we found unlawful.

The concern emphasized by CCAC stems from our primary focus in the regulation of the cellular industry--the provision of good service, reasonable rates, and customer convenience--and from our desire not to eliminate any near-term consumer benefits as long as their application does not harm consumers in the long run by discouraging competition.

Airtouch takes a different approach. It distinguishes between bundling and packaging and concludes that PU Code § 532 does not prohibit packaging. It defines bundling to be the requirement that customers purchase service in order to obtain certain telephone equipment or vice versa. In contrast, it defines packaging to be the offering of telephone equipment and services on

a packaged basis, provided both cellular service and the telephone unit are also offered separately on a nondiscriminatory basis.

It is correct, as argued by CRA, DRA, and Nextel, that PU Code § 532 prohibits public utilities, including cellular providers, from charging rates which differ from those in applicable tariffs. Such a prohibition provides a safeguard to prevent discrimination or preference with regard to tariffed products or services. However, the statute also authorizes us to establish exceptions from the operation of this prohibition. Specifically, the last sentence of PU Code § 532 states:

> "The Commission may by rule or order establish such exceptions from the operation of this prohibition as it may consider just and reasonable as to each public utility."

As cited by CCAC, we have used this provision in Reuben H. Donnelly Corp. v. Pacific Bell, 39 CPUC2d 209 [D.91-01-016], to reject a claim that a telephone utility had violated PU Code § 532 by charging its affiliated business directory publisher a rate for subscriber information that was not contained in its filed tariff and in Right-O-Way Inc. (D.90-06-067) where a highway common carrier and its customer had agreed in writing that a rate higher than the filed tariff rate was necessary to fully compensate the common carrier for the special expedited services required by the customer.

Despite its strong language, § 532 permits bundling in some circumstances. Section 532 aims to ensure that utilities do not discount tariffed services, but it also authorizes the Commission to create exceptions to § 532's prohibition by rule or order. Thus, § 532's prohibition of bundling is not absolute, and the statute grants us broad discretion to authorize exceptions to the general prohibition.

B. PU Code § 702

PU Code § 702 requires cellular utilities to secure the compliance of their agents with Commission rules and orders. Specifically, PU Code § 702 states that:

> "Every public utility shall obey and comply with every order, decision, direction, or rule made or prescribed by the commission in the matters specified in this part, or any other matter in any way relating to or affecting its business as a public utility, and shall do everything necessary or proper to secure compliance therewith by all of its officers, agents, and employees."

Bakersfield contends in its petition that a public utility's requirement to secure the compliance of its agents is restricted to tariffed services and products, the matters "affecting its business as a public utility." Therefore, unless cellular utilities require agents, as part of an agency agreement, to package cellular equipment discounts with tariffed cellular service, activities undertaken by agents or their own are not subject to Commission jurisdiction or the bundling prohibition.

On the other side of this issue, Nextel contends that D.89-07-019 applies § 702 to find that agents cannot discount cellular equipment contingent upon the purchase of cellular service. Nextel reads D.89-07-019 to conclude that discounts on cellular equipment contingent upon the purchase of cellular service are unlawful if those discounts are offered by utilities or their agents.

As previously discussed, D.89-07-019 was the result of a CRA complaint against AirTouch and LASMSA. In that order, we noted that bundling would be lawful for agents if the same practice undertaken by the utility is lawful. (32 CPUC2d at 280.) This test, applied to the CRA complaint and facts presented in that proceeding, resulted in the conclusion cited by Nextel.

AirTouch argues that D.89-07-019 was mistaken in holding that packaging by an agent constitutes an indirect discount by the utility on tariffed services under PU Code § 702, a conclusion that is valid only if the cellular carrier requires packaging as a condition of its agency. Otherwise, according to Airtouch, the decision by an independent unregulated sales representative to reduce prices for unregulated equipment is a voluntary reduction on commissions by the sales representative, a matter over which the Commission has no jurisdiction.

Irrespective of AirTouch's belief that a mistake was made in D.89-07-019, that matter is not now being reconsidered. The time for the filing of an application for rehearing of that order lapsed years ago. Therefore, AirTouch's argument has no impact on the test, established in D.89-07-019, to determine whether agents can lawfully bundle cellular equipment with cellular service. That test is whether the same practice would be lawful if it were to be undertaken by the utility.

Thus, we continue to hold that § 702 permits bundling by agents to the extent that bundling by a utility is lawful. In other words, PU Code § 702 does preclude agents from voluntarily bundling discounts on cellular equipment with cellular utilities' tariffed services. However, were we to allow an exception to permit bundling by the wholesale carriers under § 532, we believe that PU Code § 702 permits agents to bundle nontariffed products or services with cellular utilities' tariffed services.

C. **B&P Code § 16727**

B&P Code § 16727 provides that:

> "It shall be unlawful for any person to lease or make a sale or contract for the sale of goods, merchandise, machinery, supplies, commodities for use within the State, or to fix a price

> charged therefor, or discount from, or rebate upon, such price, on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, merchandise, machinery, supplies, commodities, or services of a competitor or competitors of the lessor or seller, where the effect of such lease, sale or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of trade or commerce in any section for the State."

CRA asserts, "Bundling is an unlawful tie-in under the Cartwright Act Antitrust Law" (B&P Code § 16727). A tie-in, as explained by CRA, occurs when a seller conditions or denies a product or service unless the buyer also purchases or leases the tied product to the exclusion of competitors for the sale of the tied product. CRA represents that in this particular case, the tying product is cellular telephones and the tied product is cellular service.

CRA acknowledges that tie-ins violate antitrust laws only under certain conditions, typically where the seller wields market power in the tying product.

In painting its economic tie-in picture, CRA reasons that facilities-based cellular carriers have market power by virtue of the FCC-created geographic duopoly, which precludes any other facilities-based cellular competition in FCC-defined service areas.

Although resellers may compete with the duopoly carriers for retail subscribers, CRA explains that it is the duopoly carriers who set the wholesale price for such service. Resellers may purchase cellular service only by the promotion of a viable, unfettered resale program requiring the duopolist carriers to provide resellers with as many activation numbers and as much cellular service as the resellers can sell to the public. Consequently, CRA believes that the existence of a regulated duopoly supports a finding that duopoly carriers and their retail

agent networks have considerable economic power in the sales of cellular telephones or bundling of cellular products.

CRA also uses a market share analysis as an alternate way to look at the economic power of cellular carriers. Since duopoly carriers accounted for approximately 84% of California cellular service sales in 1990, resellers accounted for the remaining 16%. Standing alone in most markets, a market share as large as 30% may be insufficient to support a tie-in finding. However, a market share in the 50% to 60% range where a specific product is involved has supported a finding of market power.

CRA, therefore, believes that FCC-protected duopoly carriers with developed retail agent networks have a dominant position in the market for cellular phones and service. If bundling were allowed, the resellers' share of the service market as well as their viability, would be threatened because they could not compete with the duopolists' bundled prices.

Bakersfield counters CRA's contentions by arguing that cellular service would in all circumstances be available at the same tariffed rates to all end users irrespective of where they may purchase their telephone, and that equipment pricing would continue to be at the sole discretion of the equipment vendor, of which there are tens, if not hundreds, in every market. To Bakersfield's knowledge, there are no facilities-based cellular carriers in California manufacturing cellular equipment or engaging in mass retailing of equipment, conditions which could impact the applicability of B&P Code § 16727.

Bakersfield concludes that the only change resulting from bundling would be that the independent vendors would be allowed to extend additional price reductions to the customers of a particular service provider.

Not all tying arrangements are illegal. B&P Code § 16727 provides the basic criteria for considering at what point tying arrangements are illegal. The bundling or tying of cellular

equipment to cellular services is illegal only if the effect of such bundling is to substantially lessen competition or tend to create a monopoly.

Our consideration of the bundling proposal impacts both the cellular service and cellular equipment market. We find that neither condition applies here in either the equipment or cellular services market. First, the cellular equipment manufacturing market consists of large entities not regulated by this Commission. Manufacturers include Audiovox, AT&T, Ericsson, Fujitsu, Mitsubishi, Motorola, NEC, and Uniden. This market is reasonably competitive. Further, cellular equipment is distributed through a variety of channels, from wholesale cellular carriers to large retail chains. Our order allowing bundling of cellular equipment with services will not diminish the competitiveness of the equipment market.

As to cellular services, we found in D.94-08-022 that this market is already not competitive. Moreover, under Bakersfield's bundling proposal cellular companies would be precluded from discounting the tariffed rate for cellular services pursuant to PU Code § 532. Our permitting of bundling cellular equipment and services will not in and of itself make the cellular service market less competitive. We are taking steps in our Investigation 93-12-007 to encourage competition in the cellular services market, hence our D.95-03-042 in that docket setting forth the unbundling of wholesale cellular rates.

We find here, that the bundling of cellular equipment and services will not diminish competition, nor tend to create a monopoly in either the equipment or cellular service markets. Bundling, then, does not meet the criteria under B&P § 16727 that would cause us to prohibit this practice pursuant to this code section. We conclude that B&P Code § 16727 will not be violated by the type of bundling permitted if we granted an exception under PU Code § 532.

D. B&P Code § 17026.1

CRA, DRA, and Nextel contend that B&P Code § 17026.1, which became effective on January 1, 1994, prohibits bundling and affirms the Legislature's endorsement of the Commission's present prohibition of bundling cellular equipment with cellular service. B&P Code § 17026.1(c) provides that:

> "No retailer of cellular telephones shall refuse to sell a cellular telephone to any customer solely on the basis of the customer's refusal to activate the telephone with the provider of cellular service for whom the retailer is an agent. Nothing herein shall preclude a retailer from limiting the number of cellular telephones that he or she is otherwise required under this subdivision to sell to any single customer.
>
> "The intent of this subdivision is to reaffirm the Legislature's support for the Public Utilities Commission's policy that makes illegal the act, or practice, of 'bundling,' as defined and described in relevant decisions and orders of the commission." (Emphasis added.)

CRA contends that the cited language clearly identifies the Legislature's support for Commission prohibition against cellular bundling. With its application of an accepted rule of statutory construction that specific language modifies general language, CRA concludes that the Legislature enacted B&P Code § 17026.1 with the intent of removing the exemption from the Unfair Trade Practices Act for public utilities under the jurisdiction of the Commission (B&P Code § 17024). CRA further concludes that the applicability of B&P Code § 17026.1 cannot be negated with the issuance of a subsequent Commission decision.

Nextel contends that the Legislature enacted B&P Code § 17026.1 to limit the extent to which cellular service rates could be used to cross-subsidize equipment prices because the Legislature perceived a significant potential for harm to competition, as well

as harm to consumers, if cellular carriers became engaged in an intensified bidding war for customer activations.

Nextel supports its advocacy of a bundling prohibition with what it believes to be the proper interpretation of B&P Code 17026.1(e), which states:

> "Nothing in this section shall be interpreted to reduce, alter or otherwise modify the authority of the California Public Utilities Commission to regulate, in any manner, or prohibit, the payment of commissions or rebates to distributors or vendors of cellular telephones. The provisions of this section shall be effective only to the extent that they do not conflict with any applicable regulations, rules or orders promulgated or issued by the Public Utilities Commission."

Nextel interprets the statute to represent three Legislative purposes. First, the Legislature wanted to guard against cellular carriers interpreting the statute in a manner less inclusive than, or not coextensive with, the Commission's prior decisions banning bundling. Second, the Legislature wanted to guard against cellular carriers construing the statute as a limitation on the Commission's future ability to adopt, enforce or expand rules pertaining to the payment of commissions.

Finally, Nextel interprets subsection (e) to be the Legislature's desire to ensure that the Commission did not consider itself limited by the statute to adopt, expand or enforce policies pertaining to commissions in order to protect consumers, retailers, and competition from unfair practices such as pricing cellular telephones below cost through cross-subsidies generated by cellular service prices that are far above cost.

In response, the proponents of bundling provided their own interpretation of B&P Code § 17026.1. Not unexpectedly, their interpretations of the statute were the direct opposite of the bundling opponents'.

One such party, US West, contends that the Legislature has expressly given the Commission authority to overrule any or all portions of the statute. It concludes that the sole purpose of B&P Code § 17026.1(e) is to grant the Commission the right to control whether bundling of cellular equipment and cellular service is or is not allowed in California.

McCaw concludes that it is clear from subsection (e) of the statute that, rather than limiting the Commission's flexibility on the bundling issue, the Legislature intended to allow the Commission the freedom to make whatever orders on the issue the Commission deems appropriate.

Bakersfield interprets B&P Code § 17026.1 to mean that its provisions shall be effective only to the extent that it does not conflict with any applicable regulations, rules, or orders promulgated or issued by the Commission. Bakersfield, putting it more succinctly, contends that the Legislature has left the bundling question for the Commission to resolve.

Parties on both sides of the bundling issue have offered plausible arguments about the legislative intent of B&P Code § 17026.1. However, it is not necessary to examine the legislative intent unless the words of the statue create ambiguity. We need only look to the actual wording of B&P Code § 17026.1.

B&P Code § 17026.1 does not itself prohibit bundling; rather, it seeks to set some limits on bundling practices to ensure that consumers are not harmed. Subsection (a) permits the commissions and rebates earned by Cellular retailers to be used to reduce the cost of cellular equipment, up to the greater of $20 or 10% of cost. Subsection (b) requires retailers to post a sign notifying consumers of their right to purchase a cellular telephone at its advertised price, without any requirement to purchase service from a particular provider. Subsection (c) codifies the principle stated in the sign, while permitting the retailer to limit the number of cellular telephones it is required to sell at

the advertised price to a particular consumer. Subsection (c) also states that the Legislature supports Commission policy that makes illegal the act, or practice, of bundling as defined and described in relevant Commission decisions and orders.

The relevant Commission decisions and orders which define and describe illegal bundling activities have been issued in the Commission's investigation (I.88-11-040) into the regulation of cellular radiotelephone utilities. As we have discussed, the Commission's policy does not provide a blanket prohibition of bundling cellular equipment with service.

Subsection (d) gives the Commission the authority to adopt rules and regulations to implement and enforce the provisions of B&P Code § 17026.1. And most significantly, subsection (e) clarifies that the Commission retains the authority "to regulate, in any manner, or prohibit, the payment of commissions or rebates to distributors or vendors of cellular telephones." (Emphasis added.)

Viewed in its entirety, B&P Code § 17026.1 declares the Legislature's support for the Commission's actions with respect to bundling so far. It also provides for minimal consumer protection to ensure that consumers are able to purchase a cellular telephone at the advertised price without also having to subscribe to a particular provider's service. And in subsections (d) and (e), the Legislature defers to the Commission's authority to regulate in any manner this rapidly changing field.

Thus, although the Legislature supports our actions to restrict bundling, it also entrusts the Commission with the authority to loosen those restrictions in appropriate circumstances, provided that adequate consumer protections are also maintained.

E. Conclusion

In summary, the Commission is not absolutely precluded by the PU Code or by the B&P Code from authorizing cellular utilities

or other cellular providers, including agents, from bundling discounts on cellular equipment with cellular service. We will next evaluate the advantages and disadvantages of Bakersfield's bundling proposal.

IV. Consideration of Bakersfield's Proposal

Bakersfield's proposal to marry the competitive cellular equipment market with the cellular service market through the creation of a permissive bundled equipment and service market may impact consumers and the independent markets. We will examine the effect of this proposal on various segments of the larger cellular market and explore some options to Bakersfield's proposal before we reach our determination on Bakersfield's petition. We will pay particular attention to the potential effects of bundling on consumers and competition.

Competition in the cellular service market, which now consists of two regulated facilities-based carriers in each cellular market, will be expanded in many areas with the entry of an unregulated system operated by Nextel. The facilities-based carriers advertise and market their service directly through in-house employees, dealers, resellers, and retailers. However, only the existing facilities-based carriers and resellers are subject to Commission jurisdiction.

Proponents of Bakersfield's bundling proposal contend that the bundling of products and services, a common feature of many retail markets, succeeds in those markets where it makes economic sense. They believe that cellular equipment and services are ideal for bundling. Cellular telephones must be purchased, installed, activated, tested, and maintained. Although each of these functions could be arranged by different service providers, the proponents contend that one-stop shopping would be more economical, efficient and convenient for consumers.

Opponents assert that bundling will prevent dealers and resellers from competing with the duopoly carriers and thereby, substantially reduce, if not eliminate, consumers' competitive choices.

A. Impact on Competing Wireless Providers

Nextel, an unregulated firm that has begun to provide a wireless service that competes with cellular service in some areas, chose not to introduce any evidence on the impact of lifting the bundling restriction on its ability to compete in the wireless market with regulated facilities-based entities. However, other parties, such as CRA, testified that "the entry of another competitor, like Nextel, would inject a tremendous element of competition that presently doesn't exist." Similarly, McCaw's witness testified that unregulated Enhanced Specialized Mobile Radio (ESMR) providers such as Nextel will be able to bundle equipment and service without any regulatory restriction.

The entry of Nextel and other ESMR providers will add a much-needed alternative to the current duopoly. The presence of new competitors should create pressure to reduce the price of cellular service, whether it is offered independently or as part of a bundle of equipment and service. In addition, Nextel's unrestricted ability to bundle discounted equipment and service suggests that in the future the current bundling prohibition may unfairly restrain competition in this market. We believe in the general proposition that the greater the level of competition, the less the need for the protections that lie behind the bundling prohibition.

B. Other States' Bundling Experience

Parties addressed the bundling activities occurring in various states, including Connecticut, Massachusetts, Michigan, Nevada, Ohio, Rhode Island, and Texas. As asserted in various parties' initial comments to the petition, California is the only

state which does not currently allow cellular equipment to be bundled with cellular service.

1. **Unbundled Equipment Pricing**

Currently, California consumers can purchase cellular equipment on an unbundled basis at lower prices than consumers can purchase stand-alone cellular equipment in states that permit the bundling of discounts for equipment and services. For example, comparable Target advertisements for an unbundled "Flip Fone" by Motorola costing $229.99 in California would cost approximately $140.00 more, or $369.00, if purchased on an unbundled basis in Minneapolis or in Seattle.

However, qualitative market research conducted in the Michigan and Ohio cellular markets indicates that the cost of cellular equipment is the most important factor considered by individual consumers and by small businesses with less than 35 potential users who are contemplating whether to subscribe to cellular service. Similar results were found in California's Modesto, Sacramento, and Stockton areas under a 1993 customer survey conducted by independent survey firms retained by Airtouch.

U.S. West's experience, as confirmed by CRA's witness, has shown that consumers rarely buy a cellular telephone as a stand-alone purchase without also arranging for service.

2. **Bundled Equipment Pricing**

The practice of bundling in other states has alleviated the major deterrent to initial cellular service subscription, the high cost of the cellular phone, by lowering the consumer's initial outlay for equipment. CRA's witness stated that "phone prices consumers face would in all likelihood fall with the introduction of bundled equipment and service." (Exhibit 17-94, p. 10.)

There is no dispute that cellular telephone prices in California are higher, and often substantially higher, than the prices charged for the same telephones, when bundled with service, in states which permit bundling. For example, a Motorola DPC 550

"Flip-Fone," selling for between $198.00 and $247.95 without activation in California, sells for $39.99 and $1.00 with activation in Seattle and Dallas, respectively, on a six-month plan.

McCaw calculates that the cumulative impact of higher cellular phone costs in California for this specific telephone model resulted in Californians spending approximately $3.6 million and $4.5 million more in equipment costs than their counterparts in Seattle and Dallas, respectively.

Proponents of bundling also show that customers who already have cellular telephones and service benefit from bundling. Such benefits are available primarily through economies of scale obtained from increased customer growth which enables the cellular carriers to recover their fixed costs from a larger base.

Lower telephone costs in states that allow bundling have not resulted in higher cellular service rates. For example, Cellular One has not increased cellular service rates in Michigan or Ohio since 1989. In fact, Cellular One has actually lowered the rates charged for service for most customers by adding discounted plans for end users and for multi-phone accounts. The reseller market in Michigan and Ohio also provides bundled service, with 11 resellers operating in Michigan and four in Ohio.

Other benefits have included: lower churn rates (customer turnover), which results in the spreading of activation and deactivation costs over a longer time period; offering of better-quality equipment at lower cost through no-interest financing, trade-in's, trade-up's and other programs; and facilitation of the introduction of innovative service offerings such as digital technology.

On the other hand, it is clear that the discounts on cellular equipment are supported by the high profits on cellular service, profits which are in turn made possible by the duopoly market structure. We have little doubt that greater competition

among cellular providers would greatly lower profits, which in turn would reduce the providers' ability to offer discounts on equipment. Under the current unnatural market structure, equipment discounts become a form of price competition for cellular service which can be focused on new subscribers. Although we would much prefer to see healthy and direct price competition for cellular service, the consumer benefits represented by bundled equipment discounts may be the best we can hope for under the current market structure.

3. **Below-Cost Pricing**

An issue of whether cellular equipment was priced below cost was raised by equipment price comparisons between unbundled California equipment and bundled equipment in other states, such as the Motorola DPC 550 "Flip-Fone" addressed in our discussion above. The majority of price comparisons were between manufacturers' invoice price and advertised sales price.

While it appears that cellular equipment may be selling below cost in other states, analyzing the cost of cellular equipment is not a straightforward process. For example, rebates, promotional allowances, close-outs, damage discounts, and volume allowances must be considered in determining the actual equipment cost.

The prices for cellular equipment in a number of states which permit bundling are significantly below the prices for unbundled cellular equipment in California, and in some situations, such as the Motorola DPC 550 "Flip-Fone" selling for $1.00 upon activation in Seattle or Dallas, the telephones are undoubtedly priced below cost. However, California, similar to the other states, has laws which restrict the practice of below-cost pricing (e.g., B&P Code § 17043). Any bundling approval on our part must not violate or encourage any violation of below-cost pricing laws. California's prohibitions against below-cost pricing must be incorporated in any bundling authority that we may grant.